CONNECTICUT VOICES FOR CHILDREN

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Testimony in Support of Proposals in
H.B. 5673, S.B. 771, S.B. 772, S.B. 774, and S.B. 776
Finance, Revenue, and Bonding Committee
February 27, 2023

Dear Senator Fonfara, Representative Horn, Senator Martin, Representative Cheeseman, and distinguished members of the Finance, Revenue, and Bonding Committee of the Connecticut General Assembly:

My name is Patrick O'Brien, and I am testifying today on behalf of Connecticut Voices for Children (CT Voices), a research-based child advocacy organization working to ensure that Connecticut is a thriving and equitable state where all children achieve their full potential.

CT Voices is testifying in support of proposals in the following bills:

- **H.B. 5673**: An Act Concerning the Reformation of Certain Taxes and Tax Equity
- **S.B. 771**: An Act Establishing a Refundable Child Tax Credit
- **S.B. 772**: An Act Increasing the Applicable Percentage of the Earned Income Tax Credit
- **S.B. 774**: An Act Adjusting Certain Marginal Rates for the Personal Income Tax and Establishing a Capital Gains Surcharge
- **S.B. 776**: An Act Concerning a State-Wide Property Tax on Certain Residential Real Property

The testimony proceeds in six sections. The first section provides an overview of Connecticut's pre-tax income inequality, poverty rates, and unfair tax system, all of which is essential background information. The next five sections provide an overview of our support for proposals in H.B. 5673, S.B. 771, S.B. 772, S.B. 774, and S.B. 776.

1. Overview of CT's Pre-Tax Income Inequality, Poverty Rates, and Unfair Tax System

Pre-tax income inequality decreased in Connecticut in 2021, but the state still has the third highest level during a period of historic income inequality in the U.S. as a whole. For each state and the U.S. as a whole, the U.S. Census Bureau provides a summary measure of income inequality: the Gini index, which "ranges from 0, indicating perfect equality (where everyone receives an equal share), to 1, perfect inequality (where only one recipient or group of recipients receives all the income)."[1] From 2019 to 2021, the two most recent years that data are available, the Gini index measure of pre-tax income inequality decreased in Connecticut (from 0.5024 to 0.4985), even as pre-tax income inequality increased in the U.S. as a whole (from 0.4811 to 0.4848).[2] As detailed in a report we published last year, the decrease in pre-tax income inequality in Connecticut was due in large part to higher wage growth for low- and middle-wage workers compared to high-wage workers, which in turn was due largely to the increase in the state's minimum wage and the tightening of the labor market.[3] However, even with the recent decrease in pre-tax income inequality, **Figure 1** shows that, as of 2021, Connecticut still has the third highest level out of all 50 states.[4] Also, as past research has demonstrated, this high level of income inequality compared to other states is occurring during a period of historic income inequality in the U.S. as a whole.[5]

To appreciate more fully the extent of income inequality in Connecticut, **Figure 2** shows the pre-tax income distribution in 2020, the most recent year that detailed data are available from the Connecticut Department of Revenue Services (DRS).[6] The income distribution analysis here combines the tax return data from all tax filing categories—single, head of household, married filing separately, and married filing jointly—and then divides the tax filers into four groups: (1) the bottom 50 percent of the distribution, referred to as low-income families; (2) the next 40 percent of the distribution, referred to as middle-income families; (3) the next 9 percent of the distribution, referred to as high-income families; and (4) the top one percent of the distribution, referred to as the wealthy.

In Connecticut in 2020, the average wealthy family earned nearly $3.4 million compared to $84,400 for the typical (or median) middle-income family and $21,100 for the typical (or median) low-income family. Put in terms of an income inequality ratio, the average wealthy family had a pre-tax income 40.1 times greater than that of the typical middle-income family and 160.5 times greater than that of the typical low-income family.[7]

Pre-tax racial and ethnic income gaps decreased in Connecticut in 2021, but the state still has substantial gaps that tend to result in higher levels of income inequality for families of color. The detailed income data from the DRS do not include a breakdown by race and ethnicity. However, using the two most recent years of data from the U.S. Census Bureau—2019 and 2021—**Table 1** shows that pre-tax racial and ethnic income gaps decreased in Connecticut in 2021.[8] Consider the pre-tax racial income gap. Compared to a pre-tax income of $93,300 for the median white household, the median Black household had a pre-tax income of $58,600. This means that the median Black household earned $0.63 for each dollar that the median white household earned, resulting in a pre-tax racial income gap of $0.37 per dollar in 2021, down from a gap of $0.43 per dollar in 2019.

Although pre-tax racial and ethnic income gaps decreased in Connecticut in 2021, the state still has substantial gaps that tend to result in higher levels of pre-tax income inequality for families of color. Put in terms of an income inequality ratio, the average wealthy family in Connecticut in 2021 had a pre-tax income 39.9 times greater than that of the median white household compared to 66.8 times greater than that of the median Black household and 71.3 times greater than that of the median Hispanic household.[9] The state's substantial pre-tax racial and ethnic income gaps are due in large part to substantial pre-tax racial and ethnic wage gaps, which in turn are due in part to discrimination in the labor market. For reference, wages and salaries are the primary sources of income for most families, but income is a broader measure that includes the money families receive from government benefits, capital gains, dividends, interest, business income, and more.

Pre-tax income inequality contributes to poverty, especially for families of color due to the additional burden of substantial racial and ethnic income gaps, and poverty negatively impacts children in "virtually every dimension" of life. All other things being equal, a higher level of pre-tax income inequality contributes to poverty because a smaller share of the benefits of the economy goes to families at the bottom of the income distribution, many of whom live in poverty.[10] This problem is even worse for families of color because substantial racial and ethnic income gaps push a disproportionate percentage of those families into the lower end of the income distribution and ultimately into poverty. Also, while poverty is a major problem overall, it is especially concerning for children because, as a landmark report from the National Academy of Sciences explained, "a child growing up in a family whose income is below the poverty line experiences worse outcomes than a child from a wealthier family in virtually every dimension, from physical and mental health, to educational attainment and labor market success."[11]

There are multiple measures of poverty. Based on the U.S. Census Bureau's most recent Current Population Survey Annual Social and Economic Supplements (CPS ASEC), the official poverty rate averaged 9.2 percent in Connecticut from 2019 to 2021 and the supplemental poverty measure (SPM) averaged 9 percent.[12] Moreover, based on the U.S. Census Bureau's most recent American Community Survey (ACS), the poverty rate was 10.1 percent in Connecticut in 2021.[13] For an overview of child poverty, **Table 2** shows the level in Connecticut in 2021 for children overall and by race and ethnicity using the most recent ACS Public Use Microdata Sample (PUMS).[14] Nearly 92,000, or 12.8 percent, of children in Connecticut live in households below the poverty level and nearly 50,000, or 6.9 percent, live in households below 50 percent of the poverty level (i.e., deep poverty). The rates are even higher for children of color. For Black children, the poverty rate is 19.8 percent, and the deep poverty rate is 9.9 percent. For Hispanic or Latino/a/x children, the poverty rate is 26.1 percent, and the deep poverty rate is 13.7 percent. To further understand the degree to which children of color in Connecticut disproportionately live in households below the poverty level, consider the following: Black children comprise 11.7 percent of the total child population but account for 18.1 percent of the child population in poverty, and Hispanic or Latino/a/x children comprise 26.5 percent of the total child population but account for 54.2 percent of the child population in poverty.

Connecticut's tax system is unfair because it disproportionately burdens low- and middle-income families, which increases post-tax income inequality and offsets in part the recent, important reduction in pre-tax income inequality. Using the most recent tax incidence data available from the Connecticut Department of Revenue Services, **Table 3** shows the effective state and local tax rate in Connecticut by income decile.[15] Three terms are necessary to define. "Tax incidence" is an estimate of the total tax burden on families (or tax filers)—specifically, the direct tax burden on families plus the indirect tax burden that comes from businesses that shift their tax liability to families through higher prices and/or lower compensation. "Effective state and local tax rate" is a measure of the combined state and local tax burden as a percentage of income, meaning it incorporates a family's ability to pay. "Income deciles" divide families into ten groups, with each group constituting ten percent of the state's adjusted gross income.[16] In general, variation in the effective tax rate across income deciles results in one of three types of tax systems: an unfair (or regressive) tax system requires low- and middle-income families to pay a higher percentage of their income in taxes than high-income and wealthy families; a fairer (or proportional) tax system requires all families to pay the same percentage of their income in taxes; and the fairest (or a progressive) tax system requires high-income and wealthy families to pay a higher percentage of their income in taxes than low- and middle-income families. In the case of Connecticut, the average effective state and local tax rate decreases as a family's income increases, meaning the state has an unfair tax system because it disproportionately burdens low- and middle-income families.

Combining the earlier pre-tax income data with the latest tax incidence data, **Table 4** shows the impact of Connecticut's unfair tax system on income inequality.[17] Consider the varying impact on wealthy and low-income families. In 2020, the average wealthy family made nearly $3.4 million, putting it in the ninth income decile with an average effective state and local tax rate of 7.08 percent. In comparison, the typical low-income family made $21,100, putting it in the first income decile with an average effective tax rate of 25.96 percent. After applying Connecticut's unfair tax system, the average wealthy family's income was 201.7 times greater than that of the typical low-income family, an increase of 41.2 points to the already exceptionally high pre-tax income inequality ratio of 160.5.

As addressed earlier, pre-tax income inequality decreased in Connecticut in 2021, which was a major positive development, especially considering the state's high level of pre-tax income inequality. However, as the analysis here shows, Connecticut's unfair tax system increases post-tax income inequality and thereby offsets in part the gains on the pre-tax side. Also important, as detailed in another report we published last year, Connecticut's tax system became increasingly unfair from 2011 to 2019, the only two years that tax incidence data are available.[18]

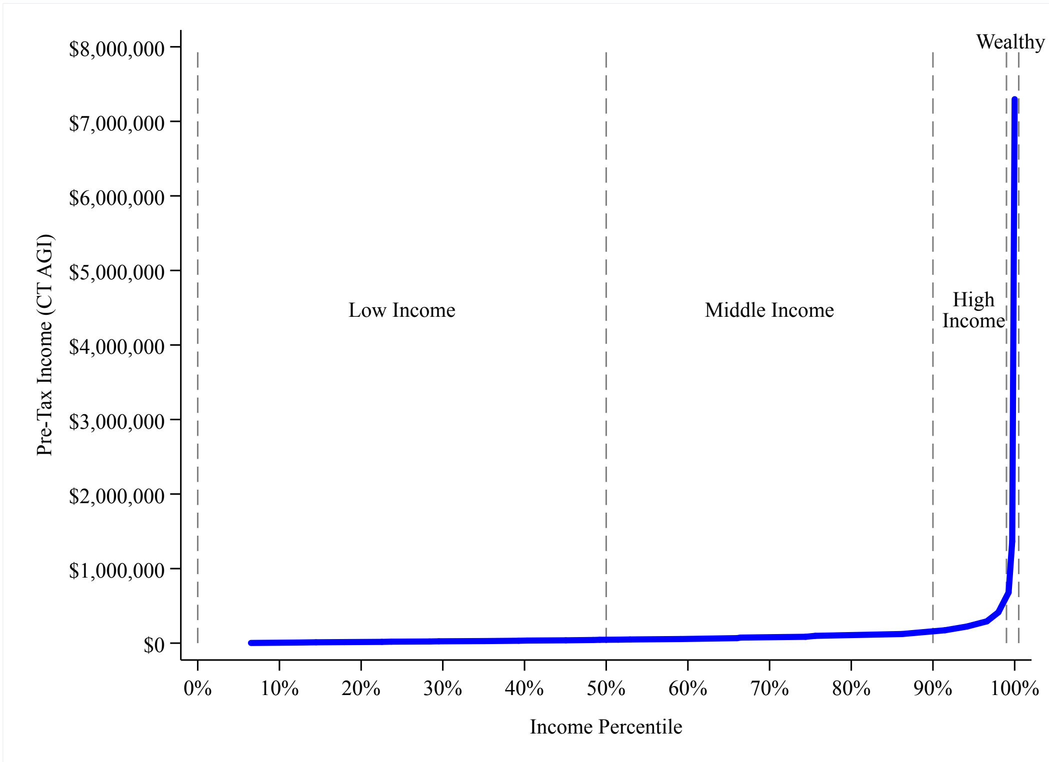
Connecticut's unfair tax system especially increases post-tax income inequality for families of color, which offsets in part both the recent, important reduction in pre-tax income inequality and the recent, important reduction in pre-tax racial and ethnic income gaps. In 2021, the typical white household made $93,300, putting it in the third income decile with an average effective state and local tax rate of 15.5 percent. In comparison to an effective tax rate of 7.08 percent for the average wealthy family and 15.5 percent for the typical white household, the typical Black household made $58,600, putting it in the second income decile with an average effective state and local tax rate of 19.55. After applying Connecticut's unfair tax system, the average wealthy family's income was 39.9 times greater than that of the typical white household, an increase of 3.6 points to the already high pre-tax income inequality ratio of 36.3. Even worse, the average wealthy family's post-tax income was 66.8 times greater than that of the typical Black household, an increase of 9 points to the already exceptionally high pre-tax income inequality ratio of 57.8.[19]

Due to the especially high average effective state and local tax rates at lower income levels that disproportionately include families of color, **Table 5** shows that Connecticut's unfair tax system offsets in part the recent, important reduction in pre-tax racial and ethnic income gaps.[20] Consider the racial income gap. Before applying state and local taxes, the typical Black household earned $0.63 for each dollar that the median white household earned, resulting in a pre-tax racial income gap of $0.37 per dollar. After applying Connecticut's unfair tax system, the median Black household earned only $0.60 for each dollar that the median white household earned, resulting in a post-tax racial income gap of $0.40 per dollar, an increase in the racial income gap of $0.03 per dollar.

Figure 1. Gini Index of Pre-Tax Income Inequality, 2021

*Data from U.S. Census Bureau.

Figure 2. Connecticut's Pre-Tax Income Distribution, 2020



*Data from the CT Department of Revenue Services and author's calculations.

Table 1. Connecticut's Pre-Tax Racial and Ethnic Income Gaps

Median Household	2019			2021		
	Income	Ratio	Gap	Income	Ratio	Gap
White	$85,800	$1.00	$0.00	$93,300	$1.00	$0.00
Black	$48,900	$0.57	-$0.43	$58,600	$0.63	-$0.37
Hispanic or Latino/a/x	$49,200	$0.57	-$0.43	$54,800	$0.59	-$0.41

*Data from the U.S. Census Bureau and author's calculations. Income rounded to the nearest hundred.

Table 2. Connecticut's Child Poverty Rate, 2021

Population Under 18 Years Old	Total	Below 100% of Poverty Level		Below 50% of Poverty Level	
		Number	Percentage	Number	Percentage
Total	719,145	91,915	12.8%	49,607	6.9%
White	387,612	29,186	7.5%	17,839	4.6%
Black	84,074	16,614	19.8%	8,311	9.9%
Hispanic or Latino/a/x/	190,579	49,777	26.1%	26,016	13.7%

*Data from the U.S. Census Bureau American Community Survey Public Use Microdata Sample and author's calculations.

Table 3. Effective State and Local Tax Rate in CT by Income Decile

Income Decile	Adjusted Gross Income	Tax Filers	Effective Tax Rate
1	$0 to $44,758	850,332	25.96%
2	$44,758 to $74,688	308,221	19.55%
3	$74,688 to $107,823	199,666	15.50%
4	$107,823 to $148,081	142,306	15.73%
5	$148,081 to $205,199	103,736	12.23%
6	$205,200 to $316,507	71,895	11.47%
7	$316,513 to $602,253	42,689	10.35%
8	$602,263 to $1,631,362	19,672	8.99%
9	$1,631,481 to $8,246,680	5,746	7.08%
10	$8,249,490 to $387,821,183	772	6.64%

*Data from the CT Department of Revenue Services.

Table 4. Impact of CT's Tax System on Income Inequality, 2020 and 2021

Tax Filer / Household	Pre-Tax		Effective Connecticut Tax Rate	Post-Tax		Change in Inequality Ratio
	Income	Inequality Ratio		Income	Inequality Ratio	
Wealthy Tax Filers						
Average Income, Top 1 Percent	$3,386,000	**1.0**	7.08%	$3,146,300	**1.0**	**0.0**
Median Income, Top 1 Percent	$1,547,800	**2.2**	8.99%	$1,408,700	**2.2**	**0.0**
High-Income Tax Filers						
Top Income, 99th Percentile	$895,800	**3.8**	8.99%	$815,300	**3.9**	**+0.1**
Median Income, 95th Percentile	$284,400	**11.9**	11.47%	$251,800	**12.5**	**+0.6**
Middle-Income Tax Filers						
Top Income, 90th Percentile	$186,100	**18.2**	12.23%	$163,300	**19.3**	**+1.1**
Median Income, 70th Percentile	$84,400	**40.1**	15.50%	$71,300	**44.1**	**+4.0**
Low-Income Tax Filers						
Top Income, 50th Percentile	$46,000	**73.6**	19.55%	$37,000	**85.0**	**+11.4**
Median Income, 25th Percentile	$21,100	**160.5**	25.96%	$15,600	**201.7**	**+41.2**
Median Households						
White	$93,300	**36.3**	15.50%	$78,900	**39.9**	**+3.6**
Black	$58,600	**57.8**	19.55%	$47,100	**66.8**	**+9.0**
Hispanic or Latino/a/x	$54,800	**61.8**	19.55%	$44,100	**71.3**	**+9.5**

*Data from CT DRS, U.S. Census Bureau, and author's calculations. Incomes rounded to the nearest hundred. Income inequality ratio is measured in relation to the average wealthy tax filer. Tax filer data is for 2020 and median household data is for 2021.

Table 5. Impact of CT's Tax System on Racial and Ethnic Income Gaps, 2021

Median Household	Pre-Tax			Post-Tax		
	Income	Ratio	Gap	Income	Ratio	Gap
White	$93,300	$1.00	$0.00	$78,900	$1.00	$0.00
Black	$58,600	$0.63	-$0.37	$47,100	$0.60	-$0.40
Hispanic or Latino/a/x	$54,800	$0.59	-$0.41	$44,100	$0.56	-$0.44

*Data from the CT DRS, U.S. Census Bureau, and author's calculations. Pre- and post-tax incomes rounded to nearest hundred.

2. Support for Proposals in H.B. 5673

This section provides an overview of CT Voices' support for proposals in H.B. 5673 and it proceeds in four parts: (1) the proposals that would raise revenue; (2) the proposals that would reduce the unfair tax burden on low- and middle-income families; (3) the proposals that would increase tax transparency; and (4) the proposal that would reduce wage theft.

Several proposals in H.B. 5673, especially increasing the top personal income tax rate and hiring auditors to close or reduce the state's tax gap, would make Connecticut's tax system fairer by raising revenue from wealthy families. Below is an overview of the bill's proposals to raise revenue and CT Voices' position.

- *Proposal*: "Establish a surcharge of five per cent of the net gain from the sale or exchange of capital assets and on dividend and interest income on a taxpayer whose Connecticut adjusted gross income is equal to or greater than the threshold amount specified in section 12-700 of the general statutes for imposition of the highest marginal rates on such taxpayer"
    - *CT Voices' position*: Establishing a surcharge on investment income for wealthy tax filers would make Connecticut's tax system fairer because it would raise revenue by increasing the tax burden on families that currently have not only the greatest ability to pay but also the lowest average effective state and local tax rate. In our December budget report—and presented here in **Table 6**—we showed that based on a historical comparison of Connecticut's top income tax rate and income base by type of income, it would be reasonable for Connecticut to increase its top tax rate on investment income.[21] Our recommended options—detailed here in **Table 7**—include raising the top rate by 1 percentage point or 2 percentage points, which would generate an estimated $185 million or $375 million a year, respectively.[22] One concern, however, is that the combination of the volatility cap and Bond Lock limits the state's ability to use funds from an investment income surcharge. A more useful option is to increase the top personal income tax rate on all taxable income for wealthy families rather than on only investment income.

- *Proposal*: "Establish additional marginal rates for the personal income tax of nine and fifty-five-hundredths per cent, ten and twenty-five-hundredths per cent and ten and sixty-five-hundredths per cent, for Connecticut taxable income of over one million dollars, ten million dollars and twenty-five million dollars respectively, for unmarried individuals and married individuals filing separately and for proportional Connecticut taxable income for individuals filing as heads of households and married individuals filing jointly"
    - *CT Voices' position*: Increasing the top income tax rates for wealthy tax filers would make Connecticut's tax system fairer because it would raise revenue by increasing the tax burden on families that currently have not only the greatest ability to pay but also the lowest average effective state and local tax rate. In our December budget report, we

showed that based on a cross-state comparison of the top income tax rate and income base, it would be reasonable for Connecticut to increase its top rate on all taxable income. Specifically, **Table 8** here shows that in 2022 there were 16 states with a higher top income tax rate than Connecticut when including both the top state and top local income tax rates.[23] The average combined top rate is 6 percent for all states and 7 percent when excluding states without an income tax. The overall top rates are 14.8 percent in California and 14.78 percent in New York, both of which are more than double the top rate in Connecticut. Our recommended options for increasing Connecticut's personal income tax rate—presented here in **Table 9**—include creating a new top rate of 7.99 percent to raise $300 million a year or a new top rate of 8.29 percent to raise $500 million a year.[24]

- *Proposal*: "Establish a ten per cent tax on the annual gross revenues of any business with annual gross revenues exceeding ten billion dollars from digital advertising services"

    - *CT Voices' position*: Establishing a tax on the gross revenue of large businesses would only make CT's tax system fairer if the new tax was also coupled with a targeted tax credit that fully (or more than fully) offsets the increase in the tax burden that the impacted businesses shift to low- and middle-income families. As explained in both tax incidence reports from the DRS and several of our own reports, businesses can shift their tax burden to low- and middle-income families through higher prices and/or lower compensation. For example, the DRS' 2014 tax incidence report shows that the state's gross earnings tax (i.e., public service companies tax) is nearly as regressive as the highly regressive sales tax.[25] In general, CT Voices recommends that policymakers prioritize raising revenue through progressive taxes.

- *Proposal*: "Establish a state-wide property tax at the rate of 2 mills on commercial and residential real property with an assessed value of more than one million five hundred thousand dollars"

    - *CT Voices' position*: Establishing a statewide property tax on high-value properties would make Connecticut's tax system fairer if the tax is well designed. In our December budget report, we showed that based on a within-state comparison of Connecticut's towns with the highest and lowest mill rates, it would be reasonable for Connecticut to establish a statewide property tax on high-value, owner-occupied homes. Our options include establishing a statewide mill rate of 1 mill to 5 mills on the portion of owner-occupied homes worth more than $1.5 million, which would generate from $39 million to $195 million a year. We focused on high-value, owner-occupied homes because a tax on all commercial and residential real property could be passed through in part to low- and middle-income families. For example, if low-income families live in apartment units in a building that is worth several million dollars, the new statewide property tax on that high-valued property could be passed to low-income families through an increase in their rent. Also, to avoid a tax cliff, we focused on taxing the portion of the property above the exemption of $1.5 rather than the full value of property worth more than $1.5 million.[26]

- *Proposal*: "Increase the rate of the corporation business tax to eleven and one-half per cent" and "extend the imposition of the corporation business tax surcharge and increase the rate of such surcharge to twenty per cent"

    - *CT Voices' position*: Increasing the rate of the corporation business tax and extending the surcharge would only make Connecticut's tax system fairer if the tax increase was coupled with a targeted tax credit that fully (or more than fully) offsets the increase in the tax burden that the impacted businesses shift to low- and middle-income families. As explained in both tax incidence reports from the DRS and in several of our own reports, businesses can shift their tax burden to low- and middle-income families through higher prices and/or lower compensation. For example, the DRS' 2022 tax incidence report finds that the state's corporation business tax is regressive.[27] To be sure, there is an ongoing debate over the incidence of corporate income taxes. For example, the U.S. Treasury Department finds that the federal corporate income tax is progressive.[28] However, without further information on why the DRS' and U.S. Treasury Department's analyses of corporate income taxes differ, CT Voices recommends that policymakers prioritize raising revenue through undisputed progressive taxes, such as the personal income tax.

- *Proposal*: "Require the Department of Revenue Services to hire fifty additional in-house auditors to assist in the closing of the state's tax gap by collecting taxes and assessing penalties and interest as applicable"

    - *CT Voices' position*: Increasing the auditing capacity of the DRS would make Connecticut's tax system fairer because it would primarily raise revenue from high-income and wealthy tax filers that are currently paying less than they are required to pay in law. In our December budget report, we showed that the state could potentially generate up to $2.6 billion a year in revenue, primarily from high-income and wealthy tax filers, by providing additional funding for the DRS to eliminate or reduce the state's income tax gap. Applying to Connecticut the estimated percentage of the federal income tax gap—which the Internal Revenue Service last provided for 2016 and which is a reasonable starting point based on the lack of an official estimate from the state—**Table 10** shows that the annual net income tax gap in Connecticut in fiscal year 2023 is an estimated $2.6 billion, or 17.6 percent.[29] Moreover, applying to Connecticut the estimated distribution of the federal tax gap by income level—which the Treasury Department provides and which is a reasonable starting point based on the lack of an official estimate from the state—**Table 11** shows that the income tax gap likely overwhelmingly benefits the wealthy.[30] For example, in Connecticut in fiscal year 2023, the bottom 50 percent of tax filers account for less than an estimated $150 million, or 6 percent, of the income tax gap, and the next 40 percent of tax filers account for less than an estimated $790 million, or 30 percent, of the income tax gap. In comparison, the top five percent of tax filers account for an estimated $1.4 billion, or 53 percent, of the income tax gap, and the top one percent of tax filers alone account for an estimated $725 million, or 28 percent, of the income tax gap.

Table 6. Historical Comparison of CT's Top Income Tax Rate and Base

Year	Capital Gains Income		Dividends and Interest Income		Connecticut Adjusted Gross Income	
	Taxable Income Base for Top Rate, Joint Filer	**Top Tax Rate**	**Taxable Income Base for Top Rate, Joint Filer**	**Top Tax Rate**	**Taxable Income Base for Top Rate, Joint Filer**	**Top Tax Rate**
1990	$9,550 ($21,120 in 2022 dollars)	7%	$100,000 ($221,120 in 2022 dollars)	14%	No tax on CT AGI	
1991 to 1995	Taxed as part of CT AGI		Taxed as part of CT AGI		$0	4.5%
1996	Taxed as part of CT AGI		Taxed as part of CT AGI		$4,500	4.5%
1997	Taxed as part of CT AGI		Taxed as part of CT AGI		$12,500	4.5%
1998	Taxed as part of CT AGI		Taxed as part of CT AGI		$15,000	4.5%
1999 to 2002	Taxed as part of CT AGI		Taxed as part of CT AGI		$20,000	4.5%
2003 to 2008	Taxed as part of CT AGI		Taxed as part of CT AGI		$20,000	5.0%
2009 to 2010	Taxed as part of CT AGI		Taxed as part of CT AGI		$1,000,000	6.5%
2011 to 2014	Taxed as part of CT AGI		Taxed as part of CT AGI		$500,000	6.7%
2015 to present	Taxed as part of CT AGI		Taxed as part of CT AGI		$1,000,000	6.99%

*Data from CT Department of Revenue Services, CT General Statutes, U.S. BLS, and author's calculations.

Table 7. Options for Increasing
CT's Top Income Tax Rate on Investment Income

Applied to Capital Gains

Taxable Income by Filing Status		Current Tax Rate	Options	
Single Filer	**Joint Filer**		**1**	**2**
Over $500,000	Over $1,000,000	6.99%	7.99%	8.99%
Additional Annual Revenue			$150 million	$305 million

Applied to Capital Gains, Dividends, and Interest

Taxable Income by Filing Status		Current Tax Rate	Options	
Single Filer	**Joint Filer**		**1**	**2**
Over $500,000	Over $1,000,000	6.99%	7.99%	8.99%
Additional Annual Revenue			$185 million	$375 million

*Revenue estimates from the Institute on Taxation and Economic Policy. Rounded to nearest $5 million.

Table 8. Cross-State Comparison of Top Income Tax Rate and Base, 2022

Rank	State	Top State Income Tax Bracket			Top Local Income Tax Rate	Top State and Local Income Tax Rate
		Tax Rate	Income Base			
			Single Filer	Joint Filer		
1	California	13.30%	$1,000,000	$1,250,738	1.50%	14.80%
2	New York	10.90%	$25,000,000	$25,000,000	3.88%	14.78%
3	New Jersey	10.75%	$1,000,000	$1,000,000	1.00%	11.75%
4	Hawaii	11.00%	$200,000	$400,000	-	11.00%
5	Oregon	9.90%	$125,000	$250,000	0.69%	10.59%
6	Minnesota	9.85%	$171,220	$284,810	-	9.85%
7	Iowa	8.53%	$78,435	$78,435	1.00%	9.53%
8	Maryland	5.75%	$250,000	$300,000	3.20%	8.95%
9	Vermont	8.75%	$206,950	$251,950	-	8.75%
10	Wisconsin	7.65%	$280,950	$374,600	-	7.65%
11	Kentucky	5.00%	$0	$0	2.50%	7.50%
12	Maine	7.15%	$54,450	$108,900	-	7.15%
13	Alabama	5.00%	$3,000	$6,000	2.00%	7.00%
14	South Carolina	7.00%	$16,040	$16,040	-	7.00%
15	Washington	7.00%	Capital gains only		-	7.00%
16	Pennsylvania	3.07%	$0	$0	3.93%	7.00%
17	Connecticut	6.99%	$500,000	$1,000,000	-	6.99%
18	Nebraska	6.84%	$33,180	$66,360	-	6.84%
19	Montana	6.75%	$18,800	$18,800	-	6.75%
20	Ohio	3.99%	$110,650	$110,650	2.75%	6.74%

*Data from Tax Foundation, Tax-Rates.org, and author's calculations.

Table 9. Options for Increasing
CT's Top Income Tax Rates on CT Adjusted Gross Income

Taxable Income by Filing Status		Current Tax Rate	Options		
Single Filer	Joint Filer		1	2	3
$0 to $10,000	$0 to $20,000	3%	3%	3%	3%
Over $10,000	Over $20,000	5%	5%	5%	5%
Over $50,000	Over $100,000	5.5%	5.5%	5.5%	5.5%
Over $100,000	Over $200,000	6%	6%	6%	6%
Over $200,000	Over $400,000	6.5%	6.5%	6.5%	6.5%
Over $250,000	Over $500,000	6.9%	6.9%	6.9%	6.9%
Over $500,000	Over $1,000,000	6.99%	6.99%	7.99%	7.99%
Over $1,000,000	Over $2,000,000	6.99%	7.99%	7.99%	8.29%
Additional Annual Revenue			$300 million	$410 million	$500 million

*Revenue estimates from the Institute on Taxation and Economic Policy. Rounded to nearest $5 million.

Table 10. Estimate of Connecticut's Income Tax Gap
Based on the IRS' Estimate of the Federal Income Tax Gap

	United States, 2016		Connecticut, 2023	
	In Millions	**% of Total True Income Tax Liability**	**In Millions**	**% of Total True Income Tax Liability**
Total True Income Tax Liability	$1,740,000	100%	$14,729	100%
Income Tax Paid Voluntarily	$1,383,000	79.5%	$11,707	79.5%
Gross Income Tax Gap	$357,000	20.5%	$3,022	20.5%
Nonfiling	$32,000	1.8%	$271	1.8%
Underreporting	$278,000	16.0%	$2,353	16.0%
Underpayment	$47,000	2.7%	$398	2.7%
Enforced	$51,000	2.9%	$432	2.9%
Net Income Tax Gap	**$306,000**	**17.6%**	**$2,590**	**17.6%**

*Data from the Internal Revenue Service, CT OFA and OPM, and author's calculations.

Table 11. Estimate of Connecticut's Income Tax Gap Distribution
Based on the Treasury's Estimate of the Federal Tax Gap Distribution

Tax Filers by Income Percentile	United States, 2016		Connecticut, 2023	
	In Millions	**% of Income Tax Gap**	**In Millions**	**% of Income Tax Gap**
Up to 10th Percentile	Less than $1,530	Less than 0.5%	Less than $1	Less than 0.5%
10th to 20th Percentile	Less than $1,530	Less than 0.5%	Less than $13	Less than 0.5%
20th to 30th Percentile	$3,060	1.0%	$26	1.0%
30th to 40th Percentile	$5,202	1.7%	$44	1.7%
40th to 50th Percentile	$7,344	2.4%	$62	2.4%
50th to 60th Percentile	$11,628	3.8%	$98	3.8%
60th to 70th Percentile	$16,830	5.5%	$142	5.5%
70th to 80th Percentile	$25,092	8.2%	$212	8.2%
80th to 90th Percentile	$39,474	12.9%	$334	12.9%
90th to 100th Percentile	$196,452	64.2%	$1,663	64.2%
Top 5 Percent	$161,262	52.7%	$1,365	52.7%
Top 1 Percent	$85,680	28.0%	$725	28.0%
Total	**$306,000**	**100%**	**$2,590**	**100%**

*Data from the U.S. Department of the Treasury, IRS, CT OFA and OPM, and author's calculations.

Several proposals in H.B. 5673, especially increasing the CT EITC and establishing a permanent CT CTC, would make Connecticut's tax system fairer by reducing the tax burden on low- and middle-income families. Below is an overview of the bill's tax-cutting proposals and CT Voices' position.

- *Proposal*: "Increase the applicable percentage of the earned income tax credit to forty-one and one-half per cent of the federal earned income tax credit"

    - *CT Voices' position*: Increasing the Connecticut earned income tax credit (CT EITC) from 30.5 percent to 41.5 percent would increase the maximum credit by the following amounts in 2023: from $183 to $249 for tax filers with no children, an increase of $66; from $1,218 to $1,658 for tax filers with one child, an increase $439; from $2,014 to $2,741 for tax filers with two children, an increase of $726; and from $2,266 to $3,083 for tax filers with more than two children, an increase of $817.[31] Increasing the CT EITC has several major benefits.[32] It would make Connecticut's tax system fairer and reduce poverty because it is targeted at low-income families—in 2023, the CT EITC only applies to single tax filers making up to about $57,000 and married tax filers making up to about $63,000. It would especially provide increased support for low-income families with children because, as noted above, the size of the credit increases based in part on the number of children. However, as addressed below, the CT EITC is different than having an income tax credit, such as a child tax credit, specifically designed to adjust a tax filer's income tax burden based on family size and/or child care expenses. Increasing the CT EITC would also strengthen Connecticut's economy by increasing the purchasing power of low-income families and encouraging work. Based on all these benefits and more, CT Voices recommends that policymakers increase the CT EITC. CT Voices also recommends that policymakers make the CT EITC available to immigrant families, who work and pay taxes—they file using an Individual Taxpayer Identification Number—but are currently excluded from both the federal EITC and CT EITC.

- *Proposal*: "Establish a refundable child tax credit against the personal income tax of five hundred dollars per child up to three children"

    - *CT Voices' position*: Creating a refundable Connecticut child tax credit (CT CTC) of $500 per child, for up to three children, would provide a maximum credit of $500 for a family with one child, $1,000 for a family with two children, and $1,500 for a family with three children. For a comparison of this proposed CT CTC and the governor's proposed reduction in the personal income tax, a married family that has two children and an income of $100,000 would receive $1,000 from the proposed CT CTC compared to about $590 from the governor's proposed income tax cut. For another example, a single parent of two children and an income of $65,000 would receive $1,000 from the proposed CT CTC compared to $290 from the governor's proposed income tax cut. More generally, creating a refundable CT CTC has several major benefits.[33] It would make Connecticut's tax system fairer and reduce poverty because it is targeted to support low-income and middle-income families—although there is no income cutoff stated in this bill, past bills have limited the credit to single tax filers making up to $100,000 a year and married tax filers making up to $200,000 a year. It would provide support for low-income families as well as middle-income families, whereas the CT EITC is largely limited to low-income families. Creating a CT CTC would make the state more competitive in retaining and attracting taxpayers because Connecticut is currently the only high cost of living state in the U.S. with an independent income tax that does not include either a child/dependent deduction or credit designed specifically to lower the income tax burden based on the number of children and/or a child care costs. Lastly, creating a CT CTC would boost the economy by increasing the income available to low- and middle-income families, which could be used to increase spending on necessities, including child care, which in turn would make it easier for some residents, especially women, to rejoin the labor force. Based on all these benefits and more, CT Voices recommends that policymakers create a permanent, refundable CT CTC. CT Voices also recommends that policymakers make the CT CTC available to immigrant families, who work and pay taxes—they file using an Individual Taxpayer Identification Number—but are currently excluded from the federal CTC.

- *Proposal*: "Increase the amount of the property tax credit against the personal income tax to six hundred dollars and allow such credit to be refundable for individuals over sixty-five years of age"; and "establish additional property tax and rental credits and relief programs for seniors, such as a homestead exemption or a refundable property tax credit"

    - *CT Voices' position*: Increasing the Connecticut property tax credit (CT PTC) and, even more importantly, making it refundable and available to renters would have several major benefits. Like the CT EITC and CT CTC, improving the CT PTC would make Connecticut's tax system fairer, reduce poverty, and strengthen the economy. However, it would be even more effective if the CT PTC applied to renters and was not limited to residents over the age of 65. The current CT PTC is not refundable and not available to renters. Not refundable means the current credit does not provide support to many low-income families that do not have income tax liability, even if they are burdened by the property tax. Not available to renters means that the current credit does not provide support to many low- and middle-income families that do not pay the property tax directly, even if they pay indirectly through their rent. CT Voices recommends that policymakers make the CT PTC refundable and available to renters.[34]

Two proposals in H.B. 5673 would make Connecticut's tax system fairer by increasing tax transparency. Below is an overview of the bill's tax transparency proposals and CT Voices' position.

- *Proposal*: "Require the Commissioner of Revenue Services to provide additional information in the tax incidence report required under section 12-7c of the general statutes"

- *CT Voices' position*: As detailed in one of our reports last year, the 2022 tax incidence study from the DRS excluded several regressive taxes that the 2014 tax incidence study included.[35] Also, based on the existing statutory requirements, the next tax incidence study will likely exclude other regressive taxes, such as the relatively new payroll tax—and we know from the U.S. Treasury Department's analysis of the federal tax system that payroll taxes are regressive.[36] Also important, the DRS' tax incidence study does not address the state's income tax gap, which is likely substantial and likely primarily benefits high-income and wealthy tax filers. As demonstrated in our December budget report, excluding a tax gap analysis from a tax incidence study means that the tax incidence study likely understates the unfairness of Connecticut's tax system. CT Voices recommends that policymakers require future DRS tax incidence studies to incorporate (1) all the state's major taxes (for example, any tax that generates more than $50 million) and (2) how the state's tax gap, especially the income tax gap, affects the unfairness of the tax system.

- *Proposal*: "Require the Department of Revenue Services to provide information to the joint standing committee of the General Assembly having cognizance of matters relating to finance, revenue and bonding concerning the state's tax gap"
    - *CT Voices' position*: As addressed above, the state likely has a substantial tax gap, especially for the income tax; it likely primarily benefits high-income and wealthy tax filers; its exclusion from the tax incidence study likely means that the tax incidence study understates the unfairness of Connecticut's tax system; and closing or reducing the tax gap would likely generate hundreds of millions of dollars a year and potentially billions of dollars.[37] CT Voices recommends that policymakers require DRS to provide the following: (1) an estimate of the state's annual tax gap overall and by major component; (2) an overview of auditing rates each year broken down by income group; and (3) a plan for closing the tax gap, including the number of auditors required.

One proposal in H.B. 5673 would reduce wage theft, which would help to reduce pre-tax income inequality and racial and ethnic income gaps. Below is an overview of the wage enforcement proposal and CT Voices' position.

- *Proposal*: "Require the Labor Department to hire forty-five additional wage enforcement agents to investigate claims of wage theft and assess penalties and interest as applicable"
    - *CT Voices' position*: In testimony submitted earlier this year, CT Voices recommended that policymakers increase the number of wage enforcement agents for several reasons. It would help to reduce Connecticut's high level of wage inequality and substantial gender, racial, and ethnic wage gaps because wage theft disproportionately harms low-wage workers, which disproportionately includes women and workers of color. It would also help to reduce Connecticut's high level of wage inequality and substantial gender, racial, and ethnic wage gaps because public sector jobs, which are highly unionized, have a fairer

wage distribution. And it would help to boost Connecticut's job recovery, which lags the job recovery for the U.S. as a whole and includes a disproportionate loss of state and local government jobs, the sector over which policymakers have the most direct control.[38]

<u>3. Support for S.B. 771</u>

S.B. 771 would make Connecticut's tax system fairer by reducing the tax burden on low- and middle-income families through the creation of a permanent, refundable CT CTC. Below is an overview of the proposal and CT Voices' position:

- *Proposal*: Establish a refundable child tax credit against the personal income tax of $250 per child, up to three children, for single tax filers making up to $100,000 and married tax filers making up to $200,000
    - *CT Voices' position*: Creating a refundable Connecticut child tax credit (CT CTC) of $250 per child, for up to three children, would provide a maximum credit of $250 for a family with one child, $500 for a family with two children, and $750 for a family with three children. For a comparison of this proposed CT CTC and the governor's proposed income tax cut, a married family that has three children and an income of $100,000 would receive $750 from the proposed CT CTC compared to about $590 from the governor's proposed tax cut. For another example, a single parent of three children and an income of $65,000 would receive $750 from the proposed CT CTC compared to $290 from the governor's proposed income tax cut. More generally, creating a refundable CT CTC has several major benefits.[39] It would make Connecticut's tax system fairer and reduce poverty because it is targeted to support low- and middle-income families. It would make the state more competitive in retaining and attracting taxpayers because Connecticut is currently the only high cost of living state in the U.S. with an independent income tax that does not include either a child/dependent deduction or credit designed specifically to lower the income tax burden based on the number of children and/or a child care costs. Lastly, it would boost the economy by increasing the income available to low- and middle-income families, which could be used to increase spending on necessities, including child care, which in turn would make it easier for some residents, especially women, to rejoin the labor force. Based on all these benefits and more, CT Voices recommends that policymakers create a permanent, refundable CT CTC**.** CT Voices also recommends that policymakers make the CT CTC available to immigrant families, who work and pay taxes—they file using an Individual Taxpayer Identification Number—but are excluded from the federal CTC.

<u>4. Support for S.B. 772</u>

S.B. 772 would make Connecticut's tax system fairer by reducing the tax burden on low-income families through an increase in the level of the CT EITC. Below is an overview of the proposal and CT Voices' position:

- *Proposal*: Increase the applicable percentage of the earned income tax credit to forty percent of the federal earned income tax credit

  - *CT Voices' position*: Increasing the Connecticut earned income tax credit (CT EITC) from 30.5 percent to 40 percent would increase the maximum credit by the following amounts in 2023: from $183 to $240 for tax filers with no children, an increase of $57; from $1,218 to $1,598 for tax filers with one child, an increase $380; from $2,014 to $2,642 for tax filers with two children, an increase of $627; and from $2,266 to $2,972 for tax filers with more than two children, an increase of $706.[40] More generally, increasing the CT EITC has several major benefits.[41] It would make Connecticut's tax system fairer and reduce poverty because it is targeted at low-income families—in 2023, the CT EITC only applies to single tax filers making up to about $57,000 and married tax filers making up to about $63,000. It would especially provide increased support for low-income families with children because, as noted above, the size of the credit increases based in part on the number of children. However, as also noted, the CT EITC is different than having an income tax credit, such as a child tax credit, specifically designed to adjust a tax filer's income tax burden based on family size and/or child care expenses. Increasing the CT EITC would also strengthen Connecticut's economy by increasing the purchasing power of low-income families and encouraging work. Based on all these benefits and more, CT Voices recommends that policymakers increase the CT EITC. CT Voices also recommends that policymakers make the CT EITC available to immigrant families, who work and pay taxes—they file using an Individual Taxpayer Identification Number—but are currently excluded from both the federal EITC and CT EITC.

5. Support for S.B. 774

S.B. 774 would make Connecticut's tax system fairer both by raising revenue from high-income and wealthy families and by lowering the personal income tax burden on middle-income families. Below is an overview of the proposals and CT Voices' position.

- *Proposal*: Increase the personal income tax rate of 6.9 percent on income over $500,000 for married filers ($250,000 for single filers) to 7.2 percent and increase the tax rate of 6.99 percent on income over $1 million for married filers ($500,000 for single filers) to 7.49 percent.

  - *CT Voices' position*: Increasing the top income tax rates for high-income and wealthy tax filers would make Connecticut's tax system fairer because it would raise revenue by increasing the tax burden on families that currently have not only the greatest ability to pay but also the lowest average effective state and local tax rate. In our December budget report, we showed that based on a cross-state comparison of the top income tax rate and income base, it would be reasonable for Connecticut to increase its top rate on all taxable income. Specifically, in 2022 there were 16 states with a higher top income tax rate than Connecticut when including both the top state and top local income tax rates.[42] The average combined top rate is 6 percent for all states and 7 percent when excluding states without an income tax. The overall top rates are 14.8 percent in California and 14.78 percent in New York, both of which are more than double the top rate in Connecticut.[43]

- *Proposal*: Establish a capital gains surcharge of 0.75 percent on income over $500,000 for married filers ($250,000 for single filers) and establish a surcharge of 1 percent on income over $1 million for married filers ($500,000 for single filers).

    - *CT Voices' position*: Establishing a surcharge on capital gains for high-income and wealthy tax filers would make Connecticut's tax system fairer because it would raise revenue by increasing the tax burden on families that currently have not only the greatest ability to pay but also the lowest average effective state and local tax rate. In our December budget report, we showed that based on a historical comparison of Connecticut's top income tax rate and income base by type of income, it would be reasonable for Connecticut to increase its top tax rate on investment income. Our recommended options include raising the top rate by 1 percentage point or 2 percentage points, which would generate an estimated $185 million or $375 million a year, respectively. One concern, however, is that the combination of the volatility cap and Bond Lock limits the state's ability to use funds from an investment income surcharge. A more useful option is to increase the top personal income tax rate on all taxable income for wealthy families rather than on only investment income.[44]

- *Proposal*: Reduce the 5.5 percent personal income tax bracket to 5 percent and adjust the benefit recapture provision to limit the tax cut to tax filers in that tax bracket.

    - *CT Voices' position*: Reducing the 5.5 percent personal tax bracket, which applies to taxable income from $100,000 to $200,000 for married tax filers ($50,000 to $100,000 for single tax filers) and adjusting the benefit capture provision to limit the tax cut to families in that income range would make Connecticut's tax system fairer because it would reduce the unfair tax burden on middle-income families. This proposal would be even more effective if coupled with the creation of a permanent, refundable CT CTC that further reduces the income tax burden for families with children, which is essential because it costs an average of about $17,000 a year to raise a child in Connecticut.

<u>6. Support for S.B. 776</u>

S.B. 776 would make Connecticut's tax system fairer by raising revenue from high-income and wealthy families. Below is an overview of the proposal and CT Voices' position.

- *Proposal*: "Establish a state-wide property tax at the rate of (1) 1 mill on residential real property with an assessed value of more than one million five hundred thousand dollars but less than two million dollars, and (2) 2 mills on residential real property with an assessed value of two million dollars or more"

- *CT Voices' position*: Establishing a statewide property tax on high-value properties would make Connecticut's tax system fairer if the tax is well designed. In our December budget report, we showed that based on a within-state comparison of Connecticut's towns with the highest and lowest mill rates, it would be reasonable for Connecticut to establish a statewide property tax on high-value, owner-occupied homes. Our options include raising the mill rate by 1 mill to 5 mills on the portion of owner-occupied homes worth more than $1.5 million, which would generate from $39 million to $195 million a year. We focused on high-value, owner-occupied homes because a tax on all residential property could be passed through in part to low- and middle-income families. For example, if low-income families live in apartment units in a building that is worth several million dollars, the new statewide property tax on that high-valued property could be passed to the low-income families through an increase in their rent. Additionally, we focused on taxing the portion of the property above the exemption to avoid a tax cliff. For example, if the one mill statewide property tax is not applied to the portion over the exemption but rather the entire amount once the exemption is exceeded, then a home assessed at a value of $1,500,001 would be taxed $1,500 whereas a home assessed at a value of $1.5 million would not be subject to the tax. CT Voices supports establishing a reasonable statewide property tax on high-value, owner-occupied homes and high-value, individual rental units, with the tax applying to the portion above the exemption (e.g., $1.5 million or higher).[45]

JUST FACTS

- Pre-tax income inequality decreased in Connecticut in 2021, but the state still has the third highest level during a period of historic income inequality in the U.S. as a whole.

- Pre-tax racial and ethnic income gaps decreased in Connecticut in 2021, but the state still has substantial gaps that tend to result in higher levels of income inequality for families of color.

- Pre-tax income inequality contributes to poverty, especially for families of color due to the additional burden of substantial racial and ethnic income gaps, and poverty negatively impacts children in "virtually every dimension" of life.

- Connecticut's tax system is unfair because it disproportionately burdens low- and middle-income families, which increases post-tax income inequality and offsets in part the recent, important reduction in pre-tax income inequality.

- Connecticut's unfair tax system especially increases post-tax income inequality for families of color, which offsets in part both the recent, important reduction in pre-tax income inequality and the recent, important reduction in pre-tax racial and ethnic income gaps.

- Several proposals in H.B. 5673, especially increasing the top personal income tax rate and hiring auditors to close or reduce the state's tax gap, would make Connecticut's tax system fairer by raising revenue from wealthy families.

- Several proposals in H.B. 5673, especially increasing the CT EITC and establishing a permanent CT CTC, would make Connecticut's tax system fairer by reducing the tax burden on low- and middle-income families.

- Two proposals in H.B. 5673 would make Connecticut's tax system fairer by increasing tax transparency.

- One proposal in H.B. 5673 would reduce wage theft, which would help to reduce pre-tax income inequality and racial and ethnic income gaps.

- S.B. 771 would make Connecticut's tax system fairer by reducing the tax burden on low- and middle-income families through the creation of a permanent, refundable CT CTC.

- S.B. 772 would make Connecticut's tax system fairer by reducing the tax burden on low-income families through an increase in the level of the CT EITC.

- S.B. 774 would make Connecticut's tax system fairer both by raising revenue from high-income and wealthy families and by lowering the personal income tax burden on middle-income families.

- S.B. 776 would make Connecticut's tax system fairer by raising revenue from high-income and wealthy families.

CT Voices urges the Finance, Revenue, and Bonding Committee to pass several key proposals in H.B. 5673, S.B. 771, S.B. 772, S.B. 774, and S.B. 776.

Thank you for your time and consideration.

Sincerely,

Patrick R. O'Brien, Ph.D.
Research and Policy Director
Connecticut Voices for Children

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